

OFFICE OF THE AUDITOR GENERAL

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OFFICE OF THE STATE CONTROLLER
REVIEW OF ADMINISTRATION
OF THE UNCLAIMED PROPERTY LAW
RELATING TO BANKS

OCTOBER 1974

Joint Legislative Audit Committee

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October 28, 1974

The Honorable Speaker of the Assembly
The Honorable President of the Senate
The Honorable Members of the Senate and the
Assembly of the Legislature of California

Members:

Transmitted herewith is the Auditor General's report pertaining to the administration and enforcement by the Office of the State Controller of the Unclaimed Property Law. The report concerns unclaimed property consisting of savings accounts, written instruments, such as money orders, and checking accounts held by banks in California.

The Uniform Disposition of Unclaimed Property Act, the predecessor of the Unclaimed Property Law, was originally enacted in 1959. After unclaimed property is "abandoned" by its owner, the banks are required to pay such monies to the Office of the State Controller who becomes the holder of the unclaimed property monies.

Since 1959, the Office of the State Controller has not effectively enforced the Unclaimed Property Law. As a result, various banks in California have underpaid the state an undetermined amount of monies during the period 1959 through 1973. During the period 1968 through 1973, the eight largest banks in California underpaid the state an estimated \$3.6 million.

During this latter period, the eight banks paid unclaimed property monies to the state amounting to approximately \$5.8 million, and therefore, their underpayment of \$3.6 million represents 38 percent of the total monies which should have been paid to the state.

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While bank records of individual accounts could be reconstructed, and while such records demonstrate that unclaimed property monies are due to the state, the total underpayments of unclaimed property monies due to the state from 1959 through 1973 cannot be reasonably estimated since adequate records are not available for estimating such a total.

It has been judicially determined that the Unclaimed Property Law requires equal treatment by the banks of the State Controller and of the banks' customers as a group. The underpayments by the banks to the state resulted from ineffective enforcement of the law in that the State Controller was not treated equally with the banks' customers.

For example, the balances of written instruments and savings accounts held by banks are required to be paid to the Office of the State Controller after being inactive usually for 7 years and 15 years respectively. Generally, if a bank customer reactivates his savings account prior to its being paid to the Office of the State Controller, he receives the interest earned on this account. On the contrary, if the account is abandoned and is paid to the Office of the State Controller, the bank excludes such interest earnings in the payment of these account balances to the State Controller.

As another example of ineffective enforcement of the law, service charges deducted by the banks from inactive savings accounts and written instruments are refunded to the customers by some banks if the accounts are reactivated. On the contrary, if such accounts are abandoned, the payment of the account balances by the banks to the Office of the State Controller is reduced by the service charge amounts previously imposed by banks.

The Auditor General has recommended that the Office of the State Controller (1) recover an estimated \$3.6 million in underpayments of unclaimed property monies which should have been paid to the state by the eight largest banks in California from 1968 through 1973, and (2) recover, to the extent possible, all other undetermined amounts representing underpayments due from all banks in California during the period 1959 through 1973.

The reasons that the Unclaimed Property Law have not been effectively enforced since 1959 by the Office of the State Controller are the lack of issuance of administrative regulations and the lack of financial audits.

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While the Office of the State Controller had the authority under the law to issue such regulations, none were issued until September 24, 1974. The absence of the regulations caused numerous inconsistencies in the banks' applications of the provisions of the Unclaimed Property Law, such as the unequal treatment previously mentioned as well as other inconsistencies. For example, bank service charges vary from a total of \$5 to \$600. These inconsistencies produce differences of hundreds, and in a few instances, thousands of dollars, in the net amount of individual unclaimed property accounts which are paid to the state.

The recent issuance of the regulations by the State Controller substantially resolves these matters and the Auditor General has concluded that the regulations are reasonable and should result in an increase in the amount of unclaimed property monies paid by the banks to the state.

Financial audits of unclaimed property held by banks are authorized under the Unclaimed Property Law. However, the Office of the State Controller has conducted only five financial audits of small banks, excluding trust department audits, from 1959 to date, and has not requested the Superintendent of Banks to conduct such audits since 1960.

It is recommended that, on a regular basis, the Office of the State Controller conduct, or request the Superintendent of Banks to conduct, financial audits of unclaimed property held by banks in order to insure that correct unclaimed property amounts are paid to the state.

The State Controller has assisted the Auditor General in obtaining access to pertinent records of the eight largest banks in California.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "Vincent Thomas", written in a cursive style.

VINCENT THOMAS, Chairman
Joint Legislative Audit Committee

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SUMMARY OF FINDINGS,
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FINDINGS

Since 1959, the Office of the State Controller has not effectively enforced the Unclaimed Property Law. As a result, various banks in California have underpaid the state an undetermined amount of monies during the period from 1959 through 1973. During the period 1968 through 1973, the eight largest banks in California underpaid the state an estimated \$3.6 million.

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The Unclaimed Property Law has not been effectively enforced by the Office of the State Controller since 1959.

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The state has not received the amounts due under the Unclaimed Property Law.

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RECOMMENDATION

- We recommend that the Office of the State Controller recover an estimated \$3.6 million in underpayments of unclaimed property monies which should have been paid to the state by the eight largest banks in California from 1968 through 1973 and, to the extent possible, recover all other undetermined amounts representing underpayments due from all banks in California from 1959 through 1973.

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- We recommend that on a regular basis the Office of the State Controller conduct, or request the Superintendent of Banks to conduct, financial audits of unclaimed property held by banks as authorized under the Unclaimed Property Law.

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BENEFITS

- Implementation of the first recommendation will result in additional funds in excess of \$3.6 million being remitted to the state for unclaimed property.
- Implementation of the second recommendation will provide assurance from independent sources that amounts of unclaimed property paid to the Controller are accurate.

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INTRODUCTION

In response to a legislative request, we have reviewed the administration and enforcement by the Office of the State Controller of the Unclaimed Property Law as it pertains to banks.

Our review of the Unclaimed Property Law was limited to an examination of applicable statutes pertaining to unclaimed property held by banks, and related policies and procedures of the State Controller and the eight largest banks in California: Bank of America, The Bank of California, Crocker National Bank, First Western Bank, Security Pacific National Bank, Union Bank, United California Bank, and Wells Fargo Bank. A questionnaire also was sent to all other banks and state savings and loan associations to determine their policies and procedures regarding unclaimed property.

The review was restricted to unclaimed checking accounts, savings accounts, and written instruments which together represent 89 percent of total amounts remitted by banks. We did not, however, identify any amounts due the state from inactive checking accounts. The review did not include items handled by bank trust departments, contents of safe deposit boxes or travelers checks.

The State Controller assisted us in obtaining access to pertinent records of the eight largest banks in California.

The objectives of the Unclaimed Property Law, originally enacted in 1959 as the Uniform Disposition of Unclaimed Property Act, as defined in State v. Pacific Far East Line, Inc. (1968) 261 CA 2d 609, are "...to protect unknown owners by locating them and restoring their property to them and to give the state rather than the holder of unclaimed property the benefit of its retention, since experience shows that most abandoned property will never be claimed...".

"Unclaimed property", as it relates to banks, includes checking accounts, savings accounts, and written instruments. After such property is "abandoned" by its owner, the banks are required to pay such property to the Office of the State Controller. Subsequent to payment by banks of unclaimed property monies to the state, the Office of the State Controller becomes the holder of such monies. The owner of such monies may claim these from this Office at any time.

The law specifies both the conditions which indicate an "abandonment" of the property by its owner (e.g., the failure to present a passbook for the crediting of interest), and the period of time from the last action by the owner until the bank is required to report such property to the Office of the State Controller (usually either seven years for written instruments or fifteen years for savings accounts). At some time during this period between the last action by the owner and the reporting by the bank to the Office of the State Controller, most banks segregate and place these dormant or inactive accounts under the control of an officer in order to reduce the risk of employee fraud. Accounts remain under this control until they are either reactivated by the owner, eliminated by service charges made by the bank or transferred to the Office of the State Controller.

The State Controller is required to publish notice of the property reported to him by banks. The notice specifies that if a claim is not presented to the bank prior to a certain date, the property will be placed in the custody of the Controller. Approximately 30 percent of the property reported by banks is claimed by the owners prior to transfer to the Office of the Controller.

The Controller is authorized to institute a legal action:

- To permit an examination of a bank's records
- To enforce the delivery of unclaimed property in the custody of a bank, and
- To obtain a judicial determination as to whether particular property is subject to the Unclaimed Property Law.

In addition, the Controller is authorized to make necessary rules and regulations to carry out the provisions of the law.

The following schedule details the total amount of unclaimed property received by the Controller for the years 1968 through 1973 from all reporting organizations. Except for the payments made by the eight largest banks, we have not evaluated whether such receipts represent the total amounts which should have been remitted to the state.

	<u>Total Remitted</u>
Amounts remitted by the eight largest banks in California* for unclaimed checking accounts, savings accounts, and written instruments	\$ 5,844,910
All other amounts remitted by banks	992,627
Other financial institutions	666,787
Other businesses	4,497,127
Life insurance companies	1,559,836
Government agencies	758,168
Other	<u>8,077</u>
Total	<u>\$14,327,532</u>

*These banks account for 87 percent of the total bank deposits in the state.

FINDINGS

SINCE 1959, THE OFFICE OF THE STATE CONTROLLER HAS NOT EFFECTIVELY ENFORCED THE UNCLAIMED PROPERTY LAW. AS A RESULT, VARIOUS BANKS IN CALIFORNIA HAVE UNDERPAID THE STATE AN UNDETERMINED AMOUNT OF MONIES DURING THE PERIOD FROM 1959 THROUGH 1973. DURING THE PERIOD 1968 THROUGH 1973, THE EIGHT LARGEST BANKS IN CALIFORNIA UNDERPAID THE STATE AN ESTIMATED \$3.6 MILLION.

The Office of the State Controller did not issue administrative regulations to effectively enforce the Unclaimed Property Law from 1959 until September 1974. Further, the Office of the State Controller has only conducted five financial audits of unclaimed property held by banks, excluding trust departments, and has not requested the Superintendent of Banks to conduct audits of unclaimed property held by banks since 1960.

As a result, underpayments of undetermined amounts of money were made by various banks in California from 1959 through 1973.

We did, however, identify that during the period 1968 through 1973 the eight largest banks in California underpaid the state an estimated \$3.6 million. This also resulted from ineffective enforcement by the Office of the State Controller of the Unclaimed Property Law.

The Unclaimed Property Law Has Not Been
Effectively Enforced by the Office of
The State Controller Since 1959.

The Unclaimed Property Law has not been effectively enforced since 1959, in that no administrative regulations for its enforcement were issued until September 24, 1974, and only five financial audits of unclaimed property, excluding audits of trust departments, held by banks have been made to date. Field audits of the Unclaimed Property Law were initiated in 1968 when the first auditor was hired for that purpose.

Lack of Administrative Regulations

The Unclaimed Property Law authorizes banks to deduct "reasonable" service charges on unclaimed property monies paid to the State Controller. While the Controller has had the authority to issue necessary rules and regulations pertaining to unclaimed property since 1959, none were issued until September 24, 1974. One reason that such rules and regulations are necessary is that prior to September 24, 1974, there was no definition of what constitutes a "reasonable" service charge.

The following inconsistencies in operations have been fostered by the lack of regulations:

1. Service Charges on Savings Accounts - Most banks levy service charges on inactive savings accounts, with the total amount varying from \$5 to a maximum of \$600. The service charges of approximately one-third of the banks vary between \$100 to \$200. As a consequence, only those customer accounts which have

balances larger than the particular bank's service charge amount are reported and paid to the Controller. On the contrary, most banks refund these charges to the customer if the account is reactivated. The practical effect of these practices is that service charges imposed by banks are used to reduce and eliminate the balances of unclaimed accounts prior to the banks paying such balances to the Controller.

2. Interest on Savings Accounts - Over one-half of the banks discontinue crediting interest to inactive savings accounts. This period during which interest is not credited varies from 5 to 12 years before payment to the Controller. Therefore, the payments of this unclaimed property to the Controller are net of interest earned on these accounts. In contrast, most banks pay these omitted interest earnings to the customer if the account is reactivated prior to being paid to the Controller.
3. Service Charges on Written Instruments - The maximum service charges levied by banks on written instruments, such as money orders and cashiers' checks, vary from \$7 to \$288. Such amounts reduce the unclaimed property monies resulting from these instruments which are paid to the Controller. On the contrary, instruments are paid at face value to payees if the items are presented for payment prior to being remitted to the Controller. Most of the large banks, but only about half of all banks, levy service charges against written instruments.

These inconsistencies produce differences of hundreds, and in a few instances, thousands of dollars, in the net amount of single accounts paid to the Controller. The administrative regulations issued September 24, 1974, as they apply to payments by banks to the state for unclaimed property, should reduce these inconsistencies in the following ways:

1. Savings Accounts - Service charges will be presumed to be reasonable only if (a) they do not exceed \$12.50, (b) they are levied only against accounts with balances of less than \$500, and (c) the payment of interest on the deposit had not been discontinued. In addition, in order for these service charges to be excluded from the balances paid by the banks to the Controller, these charges must be made against the customer if the amount is claimed by him before payment to the state is effected. Interest must be paid to the Controller unless interest would not have been paid to the customer if he had claimed the account prior to the account being paid to the Controller.
2. Written Instruments - No service charge can be deducted from payments to the Controller unless such charge is also deducted from payments to the owner if the amount is claimed before payment to the Controller.
3. Checking Accounts - Service charges on inactive accounts cannot be deducted from payments to the Controller if they exceed the service charges deducted from customers' active accounts.

Therefore, the administrative regulations issued by the Controller will (1) provide for the same treatment by the banks of the State Controller and the banks' customers, and (2) reduce the difference in the net amounts which are paid to the state by the various banks under the Unclaimed Property Law.

While we conclude that the issuance of administrative regulations by the Office of the State Controller approximately 15 years after the enactment of the Unclaimed Property Law was ineffective enforcement of the law, we also conclude that the Controller's administrative regulations of September 24, 1974 are reasonable and should result in an increase in the amount of unclaimed property monies paid by banks to the Controller.

Lack of Financial Audits

The Unclaimed Property Law authorizes the Controller to conduct financial audits of banks holding unclaimed property and to request the Superintendent of Banks to make such examinations. Although banks report more unclaimed property to the Office of the State Controller than any other type of business, only \$52,000, or four percent of the total audit exceptions resulting from unclaimed property examinations by the Controller during the last six years have been from banks. During this period the Controller conducted only five financial audits of small banks, excluding trust department audits. Previously, no such audits had been conducted by the Office of the Controller. Further, the Controller has not requested the Superintendent of Banks to conduct

such audits since 1960, and has received no information from him concerning problems in connection with audits of unclaimed property. Examination by the Controller's staff of other types of holders of unclaimed property, such as savings and loan associations and bank trust departments, have produced audit exceptions of \$1,230,000.

We conclude that conducting only five financial audits of small banks for the period 1959 to date is ineffective enforcement of the Unclaimed Property Law.

In our judgment, financial audits by either the Controller or the Superintendent of Banks would provide assurance from independent sources that amounts of unclaimed property paid to the Controller are accurate.

The State Has Not Received the Amounts
Due Under the Unclaimed Property Law

Since 1959, the state has not received all of the unclaimed property due it from banks under the Unclaimed Property Law. For reasons which will be described below, the total underpayments to the state cannot be reasonably estimated. We were able, however, to reasonably estimate the underpayments by the eight largest banks in California for the period 1968 to 1973, inclusive.

Underpayments of Undetermined
Amounts for 1959 Through 1973

Various banks in California have been permitted to retain an undetermined amount of monies which should have been paid to the state. The inability by the Office of the State Controller to collect these monies on behalf of the state directly results from the lack of administrative regulations and financial audits necessary for the effective enforcement of the Unclaimed Property Law.

While individual accounts can be reconstructed, the total unclaimed property monies which should have been paid to the state by the various banks in California cannot reasonably be estimated because:

- There are substantial variations in the amounts of service charges levied by banks, but prior to September 24, 1974, no determination has been made as to what amount is reasonable.
- Records are not retained by the banks of accounts which are eliminated by the application of bank service charges.

- Various other records, necessary for the computation of unclaimed property amounts which should have been paid to the state, are not retained by the banks.

While the total amount of unclaimed property due to the state from various California banks could not reasonably be estimated for the reasons stated above, appropriate records which are available demonstrate that amounts are in fact due.

We conclude that to the extent possible, the Controller should recover the underpayments made by various banks in California during the period 1959 through 1973.

Underpayment of an Estimated
\$3.6 Million for 1968 Through 1973

As a result of ineffective enforcement of the Unclaimed Property Law, the eight largest banks in California underpaid an estimated \$3.6 million in unclaimed property to the state from 1968 through 1973.

The case of Bank of America v. Cranston (1967) 252 Cal. App. 2d 208, states that the rights of the State Controller to unclaimed property are derivative from the rights of the owner of the unclaimed property. As a result, if banks are contractually obligated to pay customers interest on inactive accounts or refund service charges on inactive accounts, upon reactivating the accounts, then the banks are obligated to pay such interest and service charges to the state. The Bank of America case also states that a bank may not waive

its contractual rights against the owners of unclaimed property and then refuse to waive such rights against the state. Therefore, if a bank as a matter of policy voluntarily refunds to its customers service charges which it is contractually entitled to retain, it may not refuse to pay such charges to the state. Although the Bank of America decision did involve written instruments, it did not involve savings accounts. However, it is the judgment of the Chief Counsel for the Office of the Auditor General and the Legislative Counsel that the principles of law enunciated in the case clearly apply to savings accounts.

Following is an analysis of the amounts of unclaimed property monies actually paid to the state and the underpayment to the state of such monies by the eight largest banks in California. The underpayments represent amounts which the banks were either contractually obligated to pay or refund to customers, and therefore to the state, or which bank policies provide for waiver of contractual rights in favor of its customers, and therefore, must be waived in favor of the state:

	<u>Millions Of Dollars</u>
Service charges deducted and retained by banks on customers' inactive savings accounts which would have been refunded to the customer if the customer had reactivated the account	\$1.6
Interest earned on but not paid to customers' inactive savings accounts which would have been paid to the customer if the customer had reactivated the account	<u>1.1</u>
Total amounts retained from savings accounts which should have been paid to the state	\$2.7
Service charges deducted and retained by banks on written instruments (e.g., bank drafts, cashiers' checks, certified checks and money orders) which would not have been deducted from an instrument upon negotiation	<u>0.9</u>
Total estimated bank underpayments to the state	\$3.6
Total actual bank payments to the state (see page 5)	<u>5.8</u>
Total payments of unclaimed property monies which should have been paid to the state from 1968 through 1973	<u>\$9.4</u>

As can be seen above, the amounts which these banks should have but did not pay to the state, i.e., the underpayments, represent 38 percent of the total amount which should have been paid to the state.

Since it has been judicially determined that the Unclaimed Property Law requires equal treatment by the banks of the State Controller and of the banks' customers as a group, we conclude that the estimated \$3.6 million underpayment by the eight largest banks in California for service charges on savings accounts and written instruments and interest earnings on savings accounts retained by the banks from 1968 through 1973 should be recovered from the banks by the Office of the State Controller.

RECOMMENDATION

- We recommend that the Office of the State Controller recover an estimated \$3.6 million in underpayments of unclaimed property monies which should have been paid to the state by the eight largest banks in California from 1968 through 1973 and, to the extent possible, recover all other undetermined amounts representing underpayments due from all banks in California from 1959 through 1973.
- We recommend that on a regular basis the Office of the State Controller conduct, or request the Superintendent of Banks to conduct, financial audits of unclaimed property held by banks as authorized under the Unclaimed Property Law.

BENEFITS

- Implementation of the first recommendation will result in additional funds in excess of \$3.6 million being remitted to the state for unclaimed property.
- Implementation of the second recommendation will provide assurance from independent sources that amounts of unclaimed property paid to the Controller are accurate.

SUMMARY OF COMMENTS OF THE
STAFF OF THE OFFICE OF THE STATE CONTROLLER
AND THE SUPERINTENDENT OF BANKS

Office of the State Controller

1. The Controller's regulations will be effective only if the courts uphold their legality. The main emphasis has been placed on obtaining a change in the law to correct the unclaimed property problems.
2. Prior to 1968 there was no unclaimed property audit program in operation. Requests for staff have been repeatedly turned down as this has been a low priority program. With a very limited staff, a policy decision was made to direct primary audit attention to corporations and other banking activities. For these reasons, as well as the legal problems involved with the savings accounts and written instruments, financial audits of unclaimed property at banks were not emphasized.

Superintendent of Banks

Since this audit was not of the Department of Banking, the Superintendent of Banks declined to comment.



Harvey M. Rose
Auditor General

Date: October 18, 1974

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